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Withholding tax on dividends - current status in some Member States

The European Court of Justice's ("ECJ") recent landmark ruling in AllianzGI-Fonds AEVN v Autoridade Tributária e Aduaneira (C-545/19) (the "AllianzGI-Fonds AEVN case") is expected to have a significant impact on Member States' tax rules regarding dividend withholding tax ("WHT"). This newsflash describes the status and evolution of the tax treatment of dividends across the EU, including the legislative developments that are underway in certain Member States.

On 17 March 2022, the ECJ delivered a preliminary reference ruling on the *AllianzGI-Fonds AEVN* case, in which it affirmed that the free movement of capital (Article 63 of the Treaty on the Functioning of the European Union ("Article 63 TFEU")) "must be interpreted as opposing the legislation of a Member State under which dividends distributed by resident companies to a non-resident collective investment vehicle ("CIV") are subject to withholding tax, whereas dividends distributed to a resident CIV are exempt from such withholding".

The ECJ's reasoning will have considerable influence on the Member States' national tax rules. Our recent newsletter provides a detailed overview of the case.

The ECJ ruling's key implications are:

- the transparent nature of foreign funds is not important if the relevant national provisions do not take into consideration the position of the ultimate investors;
- discriminatory provisions can only be justified when the purpose of such provisions is to mitigate against tax abuses and/or eliminate economic double taxation; and
- non-EU CIVs should also be allowed to recover the WHT paid, according to the principle of free movement of capital (upon which the ECJ based its ruling).

Austria

Current legislation on dividend WHT

Austria generally levies a dividend WHT of 27.5%, which may be reduced to the prevailing corporate income tax rate of 25% if the recipient is subject to corporate income tax (for example, legal entities). The dividend WHT can be reduced at source under the applicable avoidance of double taxation agreements ("DTAs") in accordance with the formal requirements laid down in the *DBA-Entlastungsverordnung*. A recipient seeking to reduce the dividend WHT will have to provide a certificate of residence issued on Austrian form ZS-QU1 or ZS-QU2 ("COR"). Additionally, legal entities must also satisfy the relevant substance requirements. The *DBA-Entlastungsverordnung* limits the dividend WHT exemption at source in certain cases – for example, foreign foundations, trusts and investment funds do not qualify for dividend WHT exemption at source.

Implementation of the EU Parent Subsidiary Directive

The EU Parent Subsidiary Directive has been transposed into Austrian tax rules. A foreign entity covered by this Directive is exempt from dividend WHT if it has a (direct or indirect) shareholding of at least 10% and has held the shares for a period of at least one year. Additionally, the pre-requisites for providing a COR and satisfying the relevant substance requirements similarly apply. An Austrian entity holding at least 10% of the shares is also exempt from dividend WHT, although there is no requirement for the shares to be held for a period of at least one year. Relevantly, the grant of a dividend WHT exemption to a foreign entity is subject to Austrian anti-avoidance rules.

Refund of the total Austrian WHT and the Austrian tax reform

Austrian corporate income tax law includes a special provision that allows a foreign entity to apply for a refund of the total Austrian WHT – including the share of WHT that Austria is entitled to tax under the relevant DTAs – if the foreign entity is unable to credit the Austrian WHT in its state of residence (for example, because the dividend income is exempt). This special provision is currently limited to an EU- or EEA-resident corporate taxpayer.

However, the Austrian Supreme Administrative Court (VwGH 11.9.2020, Ra 2020/13/0006) found that such a limitation conflicts with the principle of free movement of capital if the foreign recipient is a portfolio investor (with a shareholding of less than 10%) as the principle also applies to a non-EU and non-EEA portfolio investor. Therefore, the recently-issued 2022 draft of the Austrian tax reform provides for an amendment to extend this special provision to non-EU and non-EEA portfolio investors where extensive administrative assistance in tax matters applies between Austria and the state of residence. The limitation to such states seems to be compatible with ECJ jurisprudence (see *X-GmbH v Finanzamt Stuttgart Körperschaften* (C-135/17), *Haribo Lakritzen Hans Riegel BetriebsgmbH v Finanzamt Linz* (C-436/08) and *Österreichische Salinen AG v Finanzamt Linz* (C-437/08)).

Despite the above, doubts remain about whether the special provisions comply with EU law in instances where the Austrian investment fund is a look-through entity and the individual shareholder is not subject to tax.

Consistency with EU law

In its decision of 13 January 2021, the Austrian Supreme Administrative Court (VwGH 13.01.2021, Ro 2018/13/0003) dealt with the question of whether a foreign trust is eligible for a WHT refund in Austria (please refer to our newsletter for details). The decision held that the Austrian investment fund taxation regime (see section 188 of the Investment Fund Law) may adopt a look-through approach for foreign funds. In this regard, some concerns have been raised as to whether the Austrian investment fund taxation regime is fully compatible with EU law.

Belgium

Portfolio dividends distributed to collective investment vehicles

As a general rule, Belgian-sourced portfolio dividends (a shareholding of less than 10%) are subject to a 30% WHT irrespective of whether they are paid to a Belgian or foreign investment fund (AIF or UCITS). Previously, a Belgian investment fund with legal personality could credit the WHT paid against its corporate income tax liability (and recover the excess) even if it involved a Belgian investment fund that was subject to a preferential tax regime (under which the investment income was generally excluded

from the tax base – for example, SICAVs, Privaks, SICAFs, B-REITs, etc.). The final tax burden on the dividends distributed to a Belgian investment fund subject to a preferential tax regime was therefore limited (or possibly fully eliminated). The ECJ in *European Commission v Kingdom of Belgium* (C-387/11) held that the preferential tax regime was discriminatory and the Belgian tax rules were amended accordingly. The resulting amendment has been detrimental to taxpayers – from 2013 onwards, a Belgian investment fund has no longer been permitted to credit Belgian WHT on portfolio dividends.

However, a Belgian investment fund may also be constituted as a normally-taxed company (and be subject to AIF regulations). If the entity also falls under the specific tax law definition of “investment company” (i.e. collective investment and risk diversification), it can then apply the Belgian shareholding exemption rules on dividends that it receives (and its investors receive on the dividends that it distributes) without having to comply with the minimum shareholder thresholds (i.e. 10% or EUR 2,500,000) and the minimum holding duration period (i.e. one year). The 30% dividend WHT can then be credited and reimbursed, resulting in a final tax burden of zero on these portfolio dividends (the aforementioned case law of the ECJ only related to funds subject to a preferential regime). On the other hand, a foreign normally-taxed company that qualifies as an “investment company” is subject to a 30% WHT on its portfolio dividends (a shareholding of less than 10%). It should be noted that such a difference in tax treatment could potentially be found to be discriminatory under EU law.

Dividends on a shareholding of more than 10% held by collective investment vehicles

In addition, if a Belgian investment fund with legal personality holds more than 10% of the share capital of a Belgian company for at least one year, it can benefit from a WHT exemption on dividends distributed by that company irrespective of its tax regime. For dividend payments made to a non-resident (investment) company, this exemption would only apply if a subject-to-tax requirement is satisfied. A foreign fund with legal personality may not necessarily fulfil this requirement since it may not be subject to tax or may be subject to a preferential tax regime. As the subject-to-tax condition does not apply to dividends distributed to a domestic fund (which may also be subject to a preferential tax regime), the Belgian tax rules were found to be discriminatory by the Brussels Court of Appeal. Consequently, an affected foreign investment fund (AIF or UCITS) may seek to reclaim the Belgian WHT paid, subject to the statute of limitation (i.e. five years from 1 January of the year of payment).

Miscellaneous

For a foreign fund without legal personality, a look-through approach would normally apply and, in such cases, regard must be had to the characteristics of the investor seeking to apply for a WHT exemption (e.g. partnerships, contractual funds,…)..

Separately, as for a foreign pension fund, the Ghent Court of Appeal recently held that the provisions relating to a dividend WHT exemption were discriminatory as they prohibited certain foreign pension funds from claiming this exemption, whereas the dividends received by a domestic pension fund were generally exempt.

Italy

Current legislation on dividend WHT

Dividends distributed by a company resident in Italy are generally subject to a 26% WHT. This applies to a recipient that is a: (a) resident or non-resident individual; or (b) non-resident

company.

Implementation of the EU Parent Subsidiary Directive

A full dividend WHT exemption is granted to a resident company or a company that falls within the scope of application of the EU Parent Subsidiary Directive. A reduced dividend WHT rate of 1.2% is granted to an EU- or EEA-resident company that falls outside the Directive's scope provided that an adequate exchange of information ("EOI") system exists between Italy and the state of residence of the recipient. Additionally, the dividend WHT rate may also be reduced provided that relevant conditions set out in the applicable DTAs are satisfied.

Consistency with the EU law of the Undertakings for Collective Investment in Transferable Securities ("UCITS")

The statutory provisions relating to UCITS were modified in 2011 and 2012. In particular, Article 73, Paragraph 5-quinquies of the Income Tax Code states that "revenue of Undertakings for Collective Investment in Transferable Securities established in Italy […] is exempt from income tax, provided that the fund or the entity in charge of management is subject to forms of prudential supervision".

The WHT exemption provision has led to a differentiated tax treatment between resident and non-resident undertakings. Due to this disparity, some foreign undertakings resident in other Member States have relied on ECJ jurisprudence to pursue their respective refund claims with the Italian tax authority.[1] Separately, the European Commission has commenced an investigation into this provision to ascertain if it complies with EU law.

Italian tax reform

The 2021 Budget Law (Law 178/2020, Article 1, Paragraphs 631-633) has extended the beneficial tax treatment to UCITS established in an EU or EEA state provide that an adequate EOI system exists between Italy and the state of residence of the recipient. This exemption applies to a UCITS irrespective of whether or not it complies with the UCITS Directive. However, in the case of the latter, the UCITS's management must be subject to prudential supervision in the state in which the undertaking is established.[2]

Pertinently, the change in tax treatment brought about by the 2021 Budget Law would only apply to dividends distributed from 1 January 2021. The divergence in tax treatment therefore continues to be a matter of dispute for dividends distributed prior to that date.

Spain

Current legislation on dividend WHT

A resident or non-resident investment fund receiving dividends from a company resident in Spain is, in the first instance, subject to a 19% WHT at source.

However, a resident investment fund – irrespective of whether such a fund is harmonised (i.e. UCITS) or non-harmonised (i.e. AIF) – pays corporate income tax at the rate of 1%, and so recovers the WHT withheld at source.

Since 2010, as a consequence of the amendment of the Law on Non-Resident Income Tax, a non-resident harmonised investment fund is also taxed at 1%, with the Law on Non-Resident Income Tax setting out the mechanism for seeking a refund of the WHT withheld at source. The 2010 amendment was enacted following a series of

[1] There is currently no EU case law addressing the differentiated tax treatment between resident and non-resident undertakings under Italian tax rules.

[2] Pursuant to Directive 2011/61/EU.

court rulings that found discrimination and infringement of Article 63 TFEU in the Spanish tax rules.

In contrast, a non-resident non-harmonised investment fund is subject to a 19% WHT at source. Unlike a harmonised investment fund, the Law on Non-Resident Income Tax does not set out a mechanism for a non-harmonised investment fund to be taxed at 1%.

Consistency with EU law

As a result of the differentiated tax treatment between harmonised and non-harmonised investment funds, a number of prominent cases involving non-harmonised investment funds have been making their way through the Spanish judicial system with mixed results. On the one hand, in 2021, the National High Court (*Audiencia Nacional*) delivered a judgment that found an infringement of Article 63 TFEU concerning non-harmonised investment funds resident in Germany, albeit with two dissenting opinions (30/07/2021). On the other hand, the Madrid High Court of Justice (*Tribunal Superior de Justicia de Madrid*) found no infringement of Article 63 TFEU for a non-harmonised investment fund resident in France (22/09/2021). Both judgments have been appealed to the Spanish Supreme Court.

Should the Spanish Supreme Court take the view that the differentiated tax treatment between harmonised and non-harmonised investment funds amounts to an unjustified discrimination and, therefore, an infringement of Article 63 TFEU, this would 'open the door' to a large number of claims. Additionally, such a ruling may also, as was the case in 2010, result in further legislative amendments to equalise the taxation of resident and non-resident non-harmonised investment funds.

Sweden

Current legislation on dividend WHT

Swedish WHT is levied at a rate of 30% on dividend distributions and certain similar payments (for example, share redemption) paid to a foreign legal entity, subject to specific exemptions. No WHT is levied on dividends paid to a recipient resident in Sweden – ordinary corporate income tax or capital tax may, however, apply. Additionally, dividend WHT may be reduced or eliminated under the applicable DTAs – dividend WHT is reduced to 15% or eliminated completely under various DTAs if the shareholder is a corporate entity holding at least 10% of the shares in the distributing entity.

Implementation of the EU Parent Subsidiary Directive

In accordance with the EU Parent Subsidiary Directive, which has been transposed into Swedish tax rules, WHT is not imposed on dividends distributed to a company that is covered by this Directive. To qualify for this exemption, the shareholding in the foreign company must be at least 10% of its share capital.

Conditions for the domestic exemption for dividend WHT

Even if the relevant conditions to qualify for tax treatment under the Directive are not satisfied, domestic exemption may be available provided that, among other things, the following requirements are met:

- » the person receiving the dividend must be classified as a foreign company. A foreign company is defined as: (a) a foreign legal person that is taxed in its state of residence and the taxation in that state is similar to the taxation in Sweden; or (b) a foreign legal person resident and subject to corporate income tax in a state with which Sweden has entered into a DTA;
- » the foreign company must be equivalent to a Swedish limited liability company (*aktiebolag*). A foreign company is

generally deemed as equivalent to a Swedish limited liability company if: (a) it is subject to income tax where it is resident (i.e. it is tax opaque); (b) the shareholders have a limited responsibility for the company's liabilities; and (c) the shareholders may not freely dispose of the company's assets; and

» the share in the Swedish company that distributes the dividend must be a capital asset (i.e. not a stock-in-trade) in the hands of the dividend's recipient.

The domestic WHT exemption is similar to the shareholding exemption applied to Swedish resident limited liability companies for corporate income tax on dividend distributions (i.e. the tax treatment for a resident and a non-resident corporate entity is similar in this respect).

Anti-avoidance rule in the Swedish Withholding Tax Act

Regardless of the above exemptions, the Swedish Withholding Tax Act contains an anti-avoidance rule under which Sweden would not grant a dividend WHT exemption where the dividend's recipient holds the shares in such a way that another party unjustifiably obtains a relief from WHT. There is, at present, limited guidance that can be derived from local case law to delineate the ambit of the anti-avoidance rule.

That being said, according to local case law, a foreign investment fund may be exempt from dividend WHT if the foreign investment fund is similar to a Swedish investment fund. A case-by-case assessment is required to determine whether the Swedish dividend WHT exemption is available.

Proposal for new legislation on dividend WHT

In 2020, the Swedish Ministry of Finance announced a legislative proposal on dividend WHT, under which dividends would continue to be subject to a 30% WHT with the notable exception that the domestic dividend WHT exemption will be limited to shareholders from within the EEA. An updated proposal is expected to be published later in 2022.

Conclusion

In our January 2022 newsletter, we speculated on the possible direction that national and European dividend WHT jurisprudence could take in the following months.

The ECJ's preliminary reference ruling in the *AllianzGI-Fonds AEVN* case and the national trends described above confirm that the free movement of capital will take the route of continuing to be a driving force for integration. Many national legislators have taken the ECJ's jurisprudence to heart and are seeking to align their national tax rules to create a more uniformed and consistent tax-legal environment for the common capital market. However, it is worth nothing that some significant differences continue to persist in the treatment of dividend WHT amongst national tax rules that threaten to undermine the free movement of capital.

In light of this, the EU Commission is pressing ahead with an initiative on the "New EU system for the avoidance of double taxation and prevention of tax abuse in the field of withholding taxes", which aims to introduce a harmonised EU-wide system for WHT on dividends and interest payments that will also include a mechanism for tax authorities to exchange information and promote greater cooperation between Member States. A proposal for such a directive is scheduled for late 2022.

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